

June 15, 1983

LETTER 863

June 3, DJIA 1213.04; PTI 1637; A-D Ratio -12.89
June 10, DJIA 1196.11; PTI 1641; A-D Ratio -13.13

THE MARKET: In the last two Letters I stressed the basic Dow Theory non-confirmation thesis. This is the "rule" (it should really be termed an observation) that *a penetration by one Average, unconfirmed by the other, is USELESS for predictive purposes and more than likely apt to be DECEPTIVE.*

In the last Letter I showed (page 1 chart) that on May 3 the two D-J Averages recorded lows, Industrials at 1204.35 and Transports at 515.80. Later in May the Industrials broke below their May 3 low. At that time they recorded a new closing low of 1190.02. But as you will note (see chart), the Transports didn't even begin to confirm (a confirmation would have entailed a Transport break below 515.80). On June 8 the Dow sank to a new closing low (below 1190.02) but again the Transports totally refused downside confirmation.

Since late-May the Industrial action has been ragged, but that's perfectly all right in a bull market. After all, if the action was too good, too easy to read, then everybody would love the market. They'd ALL climb aboard simultaneously, and the bull market would be over in a few days! But it doesn't happen that way. The bull always gives the customers something to worry about, and currently it has been the weak and erratic action of the D-J Industrial Averages.

But look at the strength in the Transports! We see on the WSI chart that there have been five successive higher Transport bottoms, bottoms occurring on March 14, April 6, May 3, May 19 and May 31. This is hardly the profile of an Average which is about to fall apart. It is hardly the profile of an Average that is about to confirm on the downside. And as I said, if Transports persistently refuse to confirm the weak indications of the Industrials, we have a market that is not going to collapse. More importantly, we have a market that, in due time, is going to move higher.

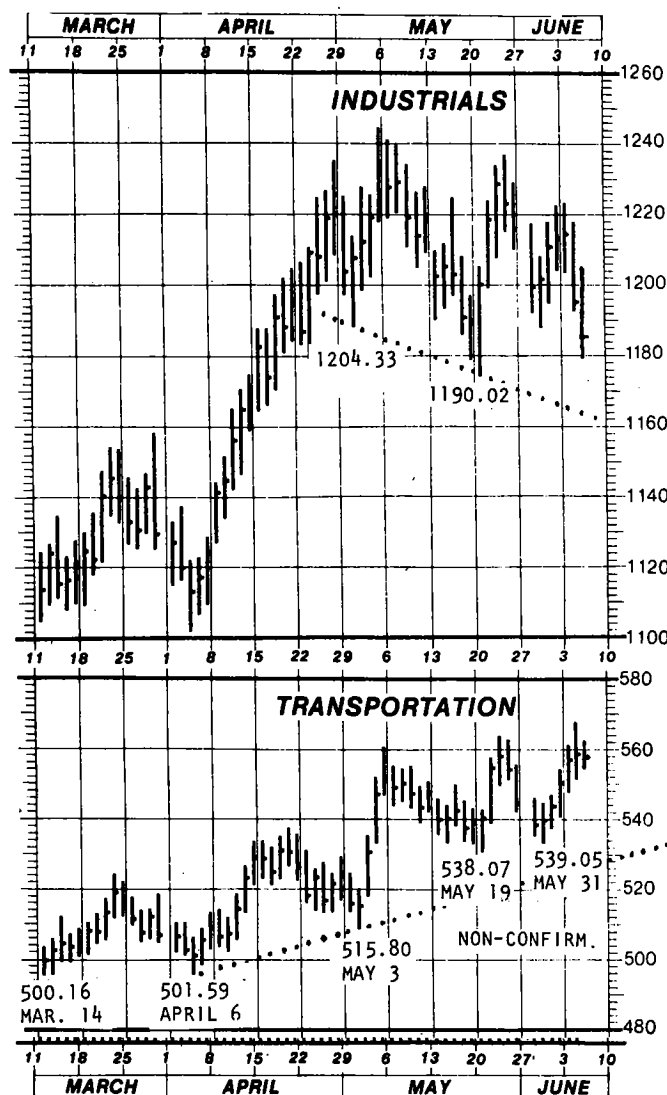
So my feeling is that at worst this market is going to do some consolidating. And in time (given Transport strength) the Averages are going to move to new highs. Actually, the longer the Averages back and fill in this area, the better I like it. A consolidation often serves to convince the bears that the market is "about to cave in." Consequently, new rounds of shorts are put out, and the technical condition of the market improves.

Conclusion: The refusal of the Transportation Average to weaken is a bullish indication. Sit tight with your no-load funds and defense stocks. Time is on the side of the bulls. Someone once said (thanks to Peter Bernstein for this one) that "a bull market is a market where you can buy late and still be a hero." That's the kind of market I think we're in.

At it's recent June peak of 1641 the Primary Trend Index (PTI) was not only at a record high, but it was extraordinarily far above its 21-week moving average (see chart). Since last August, each time the PTI has climbed too far above the moving average, the market has pulled back and the PTI has declined towards its rising trendline.

FRONT PAGE COMMENT: The predictions of "a new round of inflation" are coming through thick and fast. Me, I'm skeptical. Gold has cracked along with silver and the precious metals, the dollar is super-strong. Farm land has dropped an average of 6% over the last year, the sharpest fall-off since 1932. Commodity prices are going nowhere, business is halting in many areas (particularly the smoke-stack areas). Real interest rates have held in a high area, and if there's any real inflation coming up I don't see it yet. To top it off, the year-to-year rate of inflation in the US has cracked a rising trendline going back to the mid-1950s. So that's the "non-inflation story," as I see it.

I always take a cold and unemotional view of the PTI action. So far, as you can see on the chart, the bull trend in the PTI is intact. When that changes, the market will be in its first major corrective phase.



THE PICTURE: Gold broke badly on May 31, and the break should have surprised no readers of the Dow Theory Letters. What I was watching was the effect of the gold break on the broad Commodity Research Bureau Index. Actually, the Commodity Index held very well in the face of the smash in precious metals. So what did I conclude? I concluded that the nation is not going into a deflationary collapse (as many have feared). No, my conclusion is that for a time (maybe a few years) we're going into a period of stability. Now, if you have a stable situation there's little need to hold gold. And this is doubly true when real interest rates are holding at relatively high levels (which makes it very expensive to hold gold).

I have been having a number of thoughts on what may be coming up in the stock market, the economy, the nation and the world in general. And frankly, I find it very hard to come to a neat, clean conclusion. But I want to tell subscribers about some of the things I am thinking—so here goes.

(1) I believe Wall Street has positioned itself for a major bull market with an accompanying boom in the economy. I've talked in recent Letters about the massive upward thrust of the market, a thrust that has taken the leading averages clean out of a seventeen year "consolidation" zone. Now, I know that a lot of

analysts consider the Dow rise into the 1200 area as "just another false breakout" much like 1966 or 1973. I don't agree.

Marty Zweig keeps all sorts of historical records, and he notes in his latest report that in May we had three consecutive days in which 1100 or more stocks rose on the NYSE. He notes that until recently we never had two or more such clusters within a year. But we have had four of these clusters in this bull market, so far: one in August, one in October, one in March and the latest in May.

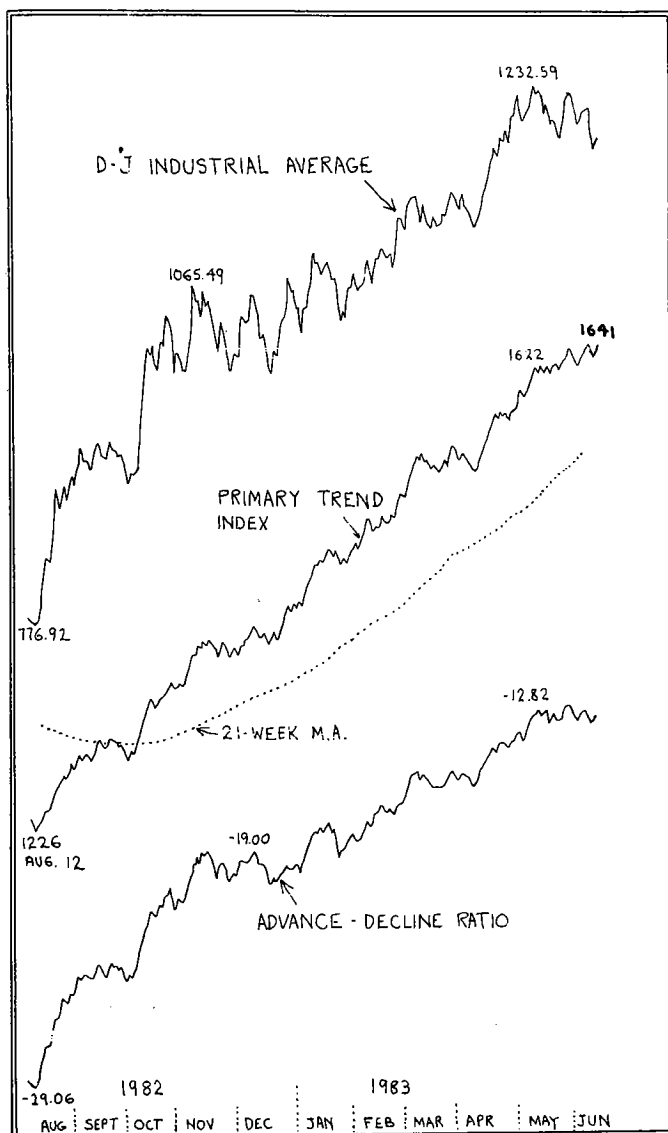
For this and other reasons Marty calls this "The most potent bull market since the early 1930s." I agree, and find it hard to believe that this bull market is going to blow itself out within less than a year. Nevertheless, many analysts believe that the market is now in the process of forming a major top, a terminal top. Again, I just don't agree.

(2) My feeling is that the economy is going to be sporadically bullish. It is not going into an all out boom phase, and actually, this could prolong the bull market in stocks. In other words, the problems, the imbalances, the erraticness of the economic upturn will tend to *extend* the bull market.

(3) My biggest fear is the one nobody takes seriously now. And that is that the Russians are going to make a "first move" into some strategic area—perhaps the Middle East. And it will then be seen that the US will be powerless to oppose the Russians. At this point, there will be an uproar about "US military weakness", and the shock of recognition will hit full. Remember, the gigantic Russian build-up is something that is out of our hands. We can't do anything about the Russian build-up. We have only two choices: We can either take the build-up seriously or ignore it. And so far, I feel that we are somewhere in the middle—looking at it (and maybe being skeptical of it) but to some extent ignoring it too. It's as if the average American (and the average politician) just hopes that the Russian military threat will go away. But it won't.

(4) On the monetary front I trust the Bank Credit Analysts view (BCA, 3463 Peel St., Montreal Quebec, Canada H3A 1W7). States the latest (June) mailing: "Expending liquidity, a strong economic recovery and sharply rising corporate cash flows continue to underpin the US stock market. All of our major cyclical indicators continued to show very positive readings."

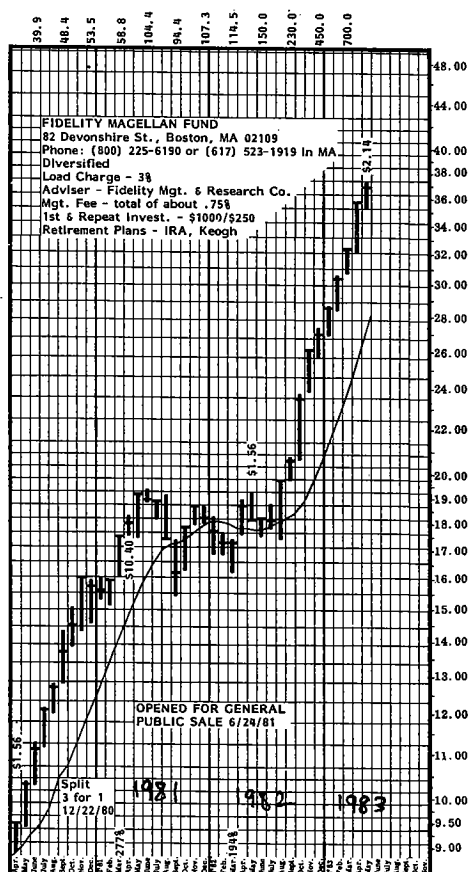
(5) Friend Bob Prechter (Elliott Wave Theorist, PO Box 1618, Gainesville, GA 30503) comments on my gold-Dow chart in Letter 861: "As Russell points out, the Dow/Gold ratio is currently near the low levels attained in the Great Depression! In other words, gold is expensive relative to stocks. While the Dow bought as many as 23 ounces of gold in 1968, today it buys less than 3! The reason is that the public has put a *high* premium on an asset which reflects *fear* of the future and a *low* premium on one that reflects *confidence* in the future. The Elliott Wave outlook of the stock market argues unequivocally that confidence will return, and, in fact, that an exuberant over-confidence will characterize the mass psychology environment four years from now. . . ."



INVESTMENT POSITION: Not too many people seem to trust it—but it's still a primary bull market. I continue to advise holding the recommended no-load funds plus the defense stocks.



You don't often see a chart of the no-load funds, but this chart (courtesy of Growth Fund Guide) shows the remarkable performance of a fund that I have recommended more than any other. It is Fidelity's Magellan Fund. My premise all along in recommending the better no-load mutual funds was, "Why try to out-do the professional in picking stocks?" The pros beat their brains out night and day in that competitive business, they have access to all kinds of information, and they know how to trade. I feel that a good no-load fund will outperform the average investor when it comes to making money in the market. It's as simple as that, and I continue to advise subscribers to buy the funds if they want to participate in the bull market.



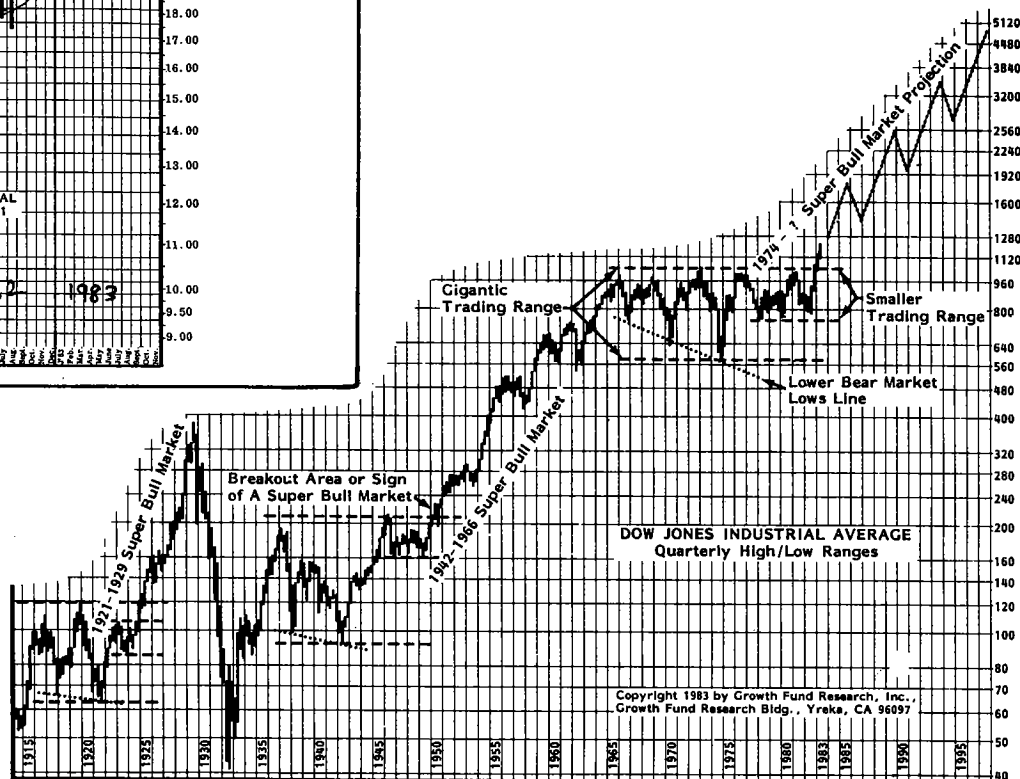
PERSPECTIVE: In Letter 861 I included a very long-term chart, a chart that called attention to the three multi-year consolidations that have occurred in the D-J Industrials since the turn of the century.

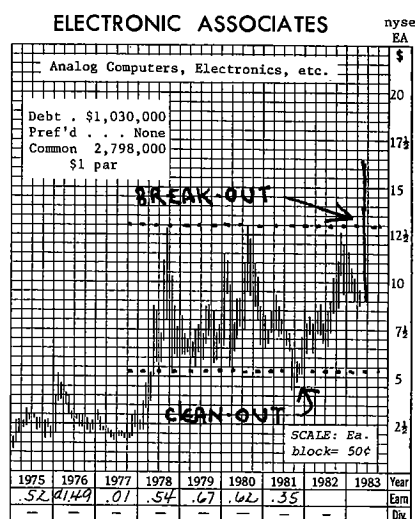
Now *Growth Fund Guide* (Yreka, CA 96097) has presented a new study that jibes with my Letter 861 piece. On the accompanying chart they show the path of the Dow going back to 1914. This study also delineates the three extraordinary "consolidation" areas of 1921-29, 1942 to 1946 and 1974 to 1983.

The study shows that during each major consolidation there was a breakdown as a later Dow low took the Dow below its preceding low. This "wipe-out" undoubtedly put stock into the hands of only the most hardened investors. Following the wipe-out decline, the Dow turned up and formed a smaller consolidation pattern. When the Dow finally climbed above this smaller consolidation pattern, a major bull market was signaled.

Growth Fund Guide notes that the longer the consolidation phase and the longer the smaller trading range and the longer the first rising wave, the longer and stronger the remainder of the super-bull market is liable to be. Based on the size of the 1974-83 consolidation, *Growth Fund Guide* believes that the current bull market could last to 1995-98. Furthermore, based on the extent of the initial thrust of the current bull market, *Growth Fund Guide* believes this bull could take the Dow to near 5000. How's that for a contrary opinion!

DEFENSE: I included Melvyn Lippman's appraisal of the military situation in the last report. It didn't make pleasant reading, but then I never sold these Letters as "comforting literature." My own belief is that we are in the midst of a grim "war" with Russia, and the war is very liable to be bloodless (I certainly hope so). But it won't be all that easy either. Because the current war is going to be a series of technical weapons,





Despite all the talk, the arms build-up goes on. And Russia continues to arm as per this little clip from last week's newspaper.

I also thought it was significant that at the recent summit of Western leaders at Williamsburg, Va., not much was said about economics. But what did make the news was the agreement by the leaders to deployment of US missiles in various sites throughout Europe.

MOSCOW (AP) — The Soviet government made a veiled threat yesterday to deploy nuclear missiles on the territory of its Warsaw Pact allies if NATO goes ahead with plans to install new medium-range U.S. rockets in Western Europe in December.

A government statement also threatened to increase the number of SS-20 missiles deployed in the European part of the Soviet Union. It warned that the Kremlin would reconsider its declared moratorium on deployment of these weapons if the North Atlantic Treaty Organization begins installing the 572 new U.S. Pershing 2 and Tomahawk cruise missiles.

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From our "Signs of the Times" Dept: Every year 10% of all unmarried US teenagers get pregnant Every year 150,000 children in the US are reported "missing."

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HELP! With its population now at 925,000, San Diego has just passed Dallas to rank as the 7th largest city in the US. I used to talk up the virtues of San Diego, but from now on it will be a policy of "super-silence" on the part of Richard Russell. In the years since 1961 (when I left Manhattan for San Diego) a lot of people have discovered what I discovered—namely, that San Diego is the best place in the country to live. But stay where you are—I was only kidding. And they still don't have any great restaurants in this town (instead of eating, everybody jogs or does aerobics here).

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According to Business Week (May 30) the party for manufacturers of personal computers is over. In 1982 giant IBM had only 17% of the personal computer market. In 1983 IBM will have 26% of that market. IBM is getting very aggressive in their pricing, having dropped its personal computer price by 20%. This forced a dozen other companies to lower their prices. But many smaller computer companies do not have the volume to enable them to keep competitive. Thus, the gravytrain is about over for personal computers.

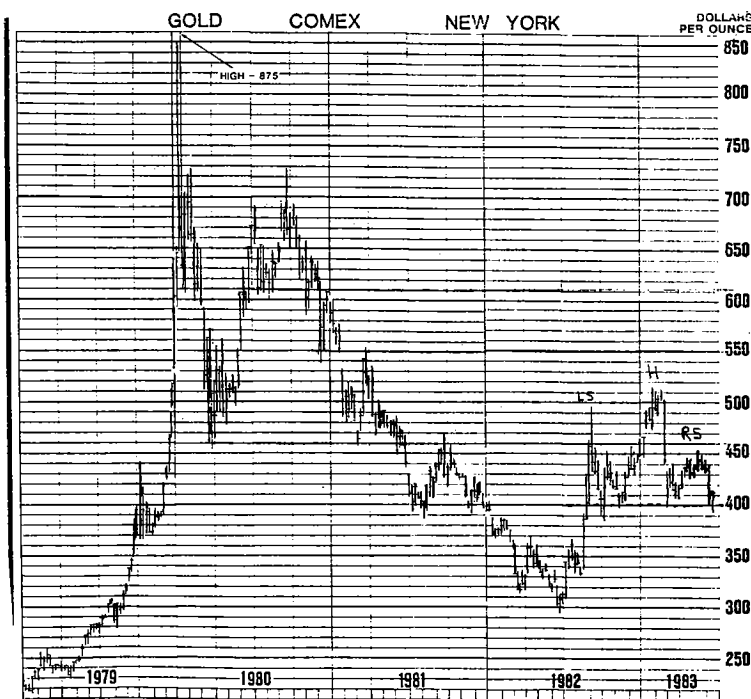
GOLD: I don't often hear from Mr. A.J. Frost, one of the leading experts on the Elliott Wave Theory (he co-authored the authoritative Elliott book with Robert Prechter). But last week I received the following from Frost:

"Thank you for your comments in your letter of April 20th. I agree with you that the price of gold is critical. I anticipate a drastic sell-off this summer, testing and possibly breaking the \$300 price level, which action would confirm a strong bull market in stocks for the next several years."

Only time will tell us whether Mr. Frost is correct, but the weekly chart provides something to think about.

As you can see, gold has formed a large head-and-shoulders top with critical support in the 395-400 area. I would think that any decisive move below 400 would trigger the full negative impact of this formation. Now obviously, not all head-and-shoulders patterns work out, but this is one of the more reliable patterns. And as a rule, I would say that the presence of a head-and-shoulders formation almost always implies that a large amount of distribution has occurred. But in some cases, this distribution is reversed, the pattern is aborted, and the item moves higher.

In the case of gold today, however, I would not count on this kind of action.



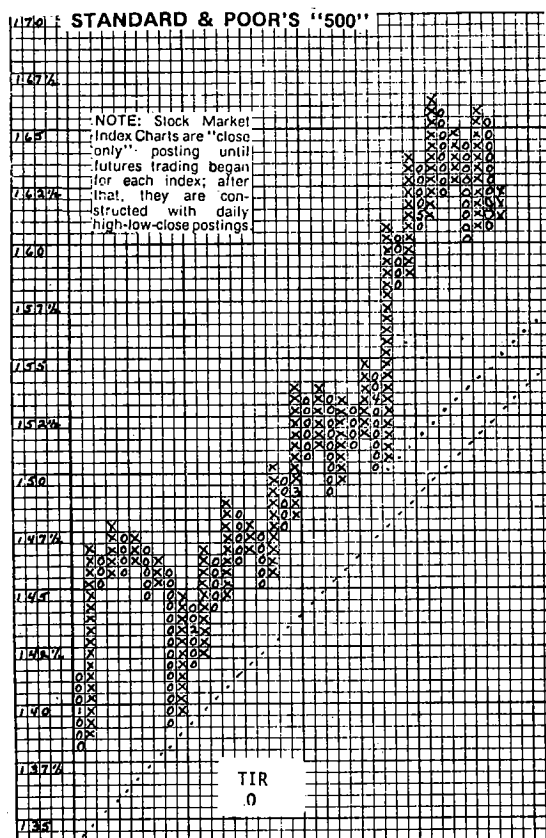
LATE NOTES: With the D-J Transportation Average surging to all-time highs, it hardly seems that the stock market is on the "verge of collapse" (as many insist). The way to look at the market is as follows: Are the Transports stronger than Industrials are weak? If they are, then they (the Transports) will support this market to the upside. In my opinion, the Transports are much stronger than the Industrials are weak. I say this because no technical damage has been done by the Industrials decline—while Transports have been achieving technical plusses—by rallying to record highs.

I am again very interested in the coming short interest totals for the NYSE and AMEX. I'm interested because if the short

interest is up again it will constitute a terrific technical plus for this market. A rising short interest within an ongoing bull market indicates rising skepticism. And there is nothing more bullish in a bull market than an army of disbelievers. And that's what a huge short interest (as now) indicates.

This point & figure chart (courtesy Chartcraft, Larchmont, NY) is of interest because it shows how far the Standard & Poor's 500 Composite is above its rising (support) trendlines. Currently, we have a high-level consolidation in the S & P 500 with support at 160. It will take a breakout to new highs (to 167) to render a true bullish signal from the 500. But I will not be surprised if that happens.

Another point to remember is that seasonally, June and July are supposed to be poor stock market months. So far, the market has acted superbly in June. If July holds in with June, the pessimists will have to look to the September-October period for a top. These are not easy times for the bears.



Here's the latest tally on our defense list. I'm not smart enough to pick which of these thirteen stocks is going up, how far and when. So I say again, buy the whole list, preferably in equal dollar amounts and SIT. If you bought the original ten in February, you know that first one, then the other will make a move. I want subscribers to have all of these, rather than pick the five or six they think will be winners. These are long-term holdings based on a long-term US military build-up. So patience will be needed. I must say, however, that patience has not been needed so far—in that the stocks are up over 40% since February 25. But we can't expect that kind of performance to continue without let-up. So you will need patience. These stocks are 3-5 year holdings.

	Our Buy Price	Current Price	
Harris Corp. (HRS)	49 1/2	43 3/4	Defense stock average based on 1 share of each this week is 360
LFE (LFE)	117 3/8	19	
Planning Research (PLN)	143 3/8	20 1/4	
Scientific Atlantic (SFA)	19	18 7/8	
Tracor (TRR) <i>25% up 0.1%</i>	28 3/4	29 5/8	
Electronic Assoc. (EA)	13	14 1/2	
Varo (VRO)	19	20 3/8	
Bolt Beranek (BBN)	37	68	
BDM (BDM) <i>(2 For 1 Split)</i>	43 1/2	111 1/2	
Dynallectron (DYN)	12 3/4	14 1/4	
Moog B (MOGB)	15 1/2	21 1/4	% Increase is: 44 %
Systems Planning (SPZ)	7	12	
American Science (ASE)	10 1/2	11 1/2	
Original purchase price 249			

Below are the latest exponential moving averages.

	Dow	PTI	Gold
Current	1196	1641	411
5-wk MA	1203		421
13-wk MA	1181		431
50-wk MA	1062		427
3-wk MA		1633	
8-wk MA		1614	
21-wk MA		1556	

Note that the Dow is just slightly below its 5-week moving average, but any rally above 1203 would be a bullish signal for the Dow (since the 5-week MA of the Dow is above the 13-week MA, and the 13 is in turn above the 50-week).

The PTI closed out the week ending June 10 at the record high of 1641. All the MA's of the PTI are in the bullish mode.

Gold is below its 5-week MA, and the 5, in turn, is below the 13-week. Gold would have to move above the 432 level to turn positive.

INTEREST RATES: The biggest guessing game in America is (and has been for years) the direction of interest rates. My guess is as good as the next guy's, and it is this—I think rates are going to stabilize around this level. During a primary bull market, things have a way of working out happily (advantageously), and stable rates, even at a high level, would be a plus. Hamilton Bolton (founder of the Bank Credit Analyst) used to say that the market can adjust to any level of interest rates, but what it can not adjust to is steadily climbing rates.

NEXT MAILING: June 29